

COMPLIANCE ASSESSMENT REFINEMENTS IMPLEMENTED

INTRODUCTION

Under the shared responsibility concept of the Mod Act, the primary focus of regulatory audit is to maximize future compliance. A Compliance Assessment (CA) is a type of importer audit performed by a Customs Compliance Assessment team, which uses traditional audit techniques, including statistical testing, and generally covers the importer's most recently completed fiscal year. A CA tests import and financial transactions to determine whether (1) the entries of the importer met an acceptable level of compliance with Customs laws and regulations during the period under review, and (2) whether the importer had documented Customs internal controls. The results of the CA are used to assign a compliance risk category for the company.

BACKGROUND

On December 6, 1999, the Commissioner of Customs announced several proposed Compliance Assessment "Refinements" to Trade representatives for the purpose of obtaining trade input. The proposed changes resulted from an ongoing effort to improve the Compliance Assessment (CA) process and address Trade concerns. As a result of overwhelming support, the U.S. Customs Service has promptly implemented the changes, most of which take effect immediately. In addressing one of the trades major concerns, the CA process was revised to incorporate lost revenue in the determination of the compliance risk category of an importer. Another major refinement incorporates a value component in the evaluation of the classification area, which ultimately figures into the designation of the compliance risk category. Additionally, these refinements result in new compliance risk categories for importers who undergo compliance assessments by Customs auditors, and also allow a conditional period for importers to complete their implementation of corrective actions to improve compliance and reduce the risk. These and other revisions are presented in detail below.

REFINEMENTS

The following proposed refinements are effective immediately:

- [Use of "Point Estimate".](#)
- [Revised materiality criteria.](#)
- [Adjusted materiality criteria for classification.](#)
- [Adjusted materiality criteria for value.](#)
- [Provision for a conditional period before designation of the compliance risk category.](#)
- [Addition of "Minimal" and "Standard" risk categories.](#)
- [Incorporation of revenue impact in designation of compliance risk categories.](#)
- [Modification of criteria for compliance risk categories.](#)

Implementation of "Point Estimate"

Effective immediately the "Letter of the Law" (LOL) compliance rate will be determined by using the "point estimate" instead of the "upper limit". Now, the compliance rate passes with five (5) errors instead of one (1) error on a current sample size of 100. For a sample size of 220, the compliance rate passes with eleven (11) errors.

Using the "point estimate" represents the average compliance rate found in the sample. Therefore, with five (5) errors the compliance rate is 95%, which passes the test. However, with six (6) errors the compliance rate is 94%, which does not pass the test. Note that this change does not alter the 95% required to achieve a passing LOL compliance rate. When sampling error is added, the 95% "point estimate" is 90%. Therefore the tested area would pass with at least 90% compliance, which is a point estimate of 95%, not an upper limit of 95% (except for the new "minimal" risk category.)

Revised Materiality Criteria

The "Materiality" criteria has been revised and is now based on 99% of the value tested instead of 99.5% applied previously.

Adjusted Materiality Criteria for Classification

Effective immediately a value test will be performed to determine whether classification is materially compliant. The new test for classification consists of a three-step process, as follows:

- Computation of the "Letter of the Law" rate based on the tenth (10th) digit level (but with six errors to fail).
- Determination of the "Materiality" rate based on the eighth (8th) digit level (but with six errors to fail).
- When the "Materiality" rate falls below 95%, the value test is applied. If compliance at the eighth (8th) digit level is at least 99% of the value of the sample value, classification is considered compliant.

Adjusted Materiality Criteria for Value

Variances in reported value will now be combined with the amount of unreported value found during the compliance assessment. The projected absolute value of reported value discrepancies will be added to the amount of unreported value. In addition, value discrepancies will be

considered material if the total is \$1,000,000 or 1% of entered value, whichever is less.

Conditional Period Before Designation of the CRC

As a means to provide responsive companies the opportunity to improve their risk category, effective immediately, companies will be afforded a conditional period of six months from the date of the report to implement their Compliance Improvement Plans (CIP). An automatic extension will be given if the company has implemented their CIP, but Customs has not completed the validation. Based on Customs validation review, the company will be designated the appropriate compliance risk category.

On a case by case basis, conditional extensions may be granted if the company has demonstrated significant progress towards their CIP implementation.

Modification of Criteria for Compliance Risk Categories (Including Incorporation of Loss of Revenue)

Two new compliance risk categories have been added. The new "minimal" and "standard" risk categories will not take effect until October 1, 2000. In the interim the new "minimal" will go into the low risk category and the new moderate will remain in the "standard" risk category. The other two categories, high and low, will remain high and low, respectively.

Therefore, the overall compliance risk category structure will be expanded to include these two new categories, as follows:

- CRC 1 - Minimal
- CRC 2 - Low
- CRC 3 - Standard
- CRC 4 - Moderate
- CRC 5 - High

Minimal Risk Category

The criteria for achieving the "minimal" risk category is by design very stringent. Companies must be at least 95% "Letter of the Law" (LOL) compliant. This means that companies may have only one (1) error in a sample size of 100 (with no application of the materiality criteria) and have documented internal controls. In addition, companies must agree to correct systemic problems.

By achieving "minimal" risk companies will receive the lowest level of CM exams.

Low Risk Category

The criteria for the determining the low risk category is now based upon using "point estimate" rather than "upper limit" sampling. Companies that are 95% compliant (five (5) errors out of a sample size of 100) in all trade areas tested or companies that pass the materiality test (when six (6) or more errors exist), and have documented internal controls, will be designated low risk. As with the "minimal" risk category, companies must agree to correct systemic problems to be placed in the low risk category.

By achieving low risk companies will receive a lower level of CM exams and limited national and local selectivity exams.

Standard Risk Category

Companies will be designated "standard" risk if they are pending a compliance assessment or if they have had a completed compliance assessment, which resulted in the following:

- Materially compliant, but no documented internal controls.
- Materially non-compliant, but pending CIP implementation and validation.

The "standard" compliance risk category represents the risk category used during the conditional period before companies receive the risk category associated with the compliance assessment. The associated risk category will be determined based upon the effectiveness of the corrective actions implemented through the company's CIP, which will be validated by the compliance assessment team prior to designation of the compliance risk category. However, when applicable, companies must agree to implement a CIP or agree to correct systemic problems within the six-month conditional period before they can be placed into the "standard" risk category.

Companies' placed in the standard risk category will receive essentially the same number of exams as the CM baseline sampling and will be subject to both national and local cargo selectivity exams.

Moderate Risk Category

The criteria for determining the moderate risk category is now based upon using "point estimate" rather than "upper limit" sampling. Companies that are materially compliant in all trade areas tested, but do not have documented internal controls or do not agree to correct systemic problems, will be designated moderate risk. Also, companies that are materially non-compliant in one trade with a loss of revenue less than \$300,000, or materially non-compliant in two or more trade areas with a loss of revenue of less than \$100,000, will be designated moderate risk. Companies that do not agree to implement a Compliance Improvement Plan within six months will be placed into the moderate risk category instead of the "standard" risk category.

By achieving moderate risk, companies will receive CM exams that are higher than the "standard" risk category and will be subject to national and local selectivity exams. Additional summary exams may be included based upon targeted program criteria specific to the compliance assessment findings, such as GSP, 9802, etc.

High Risk Category

The high risk category is also now based upon using "point estimate" rather than "upper limit" sampling. Companies that are materially non-compliant in one trade area with a loss of revenue greater than or equal to \$300,000, or materially non-compliant in two or more trade areas with a loss of revenue greater than or equal to \$100,000, will be designated high risk. Also, companies that do not agree to implement a CIP within six months will be designated high risk instead of the "standard" risk category.

Companies designated as high risk will receive a higher number of CM exams and subject to national and local selectivity exams. As with the moderate risk category, additional summary exams may be included based upon targeted program criteria specific to the compliance assessment findings.

Implementation

A plan of action for implementing these enhancements has been developed. Some revisions have been made, while others (such as the new "minimal" and "moderate" compliance risk categories) will be implemented by October 1, 2000. Until the new "minimal" and "moderate" compliance risk categories are fully developed, the following procedures are effective. Companies that meet the new "minimal" risk category will be placed in the low risk category. Companies

meeting the criteria for the new “moderate” risk category will be placed in the standard risk category.

As part of the implementation plan, Customs will contact companies who are in the process of undergoing a compliance assessment to explain how their company may be affected by the new refinements. Additionally, Customs will contact those companies who have had a completed compliance assessment, but their compliance risk category has not been processed within Customs, to advise companies of the impact of these changes.